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A BUSINESS CYCLE BAROMETER: REAL ESTATE

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A BUSINESS CYCLE BAROMETER: REAL ESTATE

by

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A thesis submitted to the Faculty of the School of Government, Business, and International Affairs of The George Washington University in partial satisfaction of the requirements for the degree of Master of Business Administration

June 5, 1963

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INTRODUCTION

The purpose of this thesis is to attempt to add to existing knowledge on the business cycle. A cursory glance at the title indicates an intent to, in some way, compare the functioning of the business cycle with the functioning of the real estate field. This immediately brings several questions to mind. First, there are economists who exclude the real estate as a possible barometer with such statements as, "The real estate field is not a valid tool to use as an estimator", "The use of real estate as an indicator of the business cycle is not valid because there are too many types of government control influencing the real estate field", "The real estate field is entirely too volatile to be used accurately", "The use of the real estate criterion has small use in forecasting business cycles."

There is a wide range of opinions regarding the subject. Some economic reports make but passing statements such as, "real estate sales picked up" during a period of expansion, or the "real estate slump continues," during a period of contraction of the business cycle. So an effort is made to shed some light on the possible use of the real estate field as a barometer. This is a large order because economists are generally quite selective in their choice of indicators, and the use of real estate, except in limited instances, is not included.

It is the feeling of this external analyst that there should be increased emphasis on certain aspects of the real estate field such as "New Construction"

and "Housing Starts and Applications for Financing".[1] These indicators are utilized consistently because they fall within the "new" category required for inclusion in the estimate of the country's gross national product (GNP).

Another use is found under the titles of "New Private Non Farm Dwelling Units Started" and "Index of New Private Housing Units Authorized by Local Building Permit".[2] These latter two have been designated by the National Bureau of Economic Research (NBER) as "leading indicators" because they, along with twenty eight other series, "usually reach peaks and troughs before those in aggregate economic activity".

A summary of these two paragraphs would indicate that uses have been found for certain real estate indicators in the "new" phase of gross national product estimation. But a two-fold opportunity is presented here; first to find ways of expanding the indicators, and secondly, to find ways to utilize information other than "new" for purposes of business cycle estimation.

Hopefully, more and more economists are becoming interested in real estate as a barometer. Charles J. Hitch and Roland N. McKean[3] ask, "Does a slump in housing and a modest increase in unemployment mark the beginning of a downward spiral or just another 'rolling readjustment'?" This is an example of the very point to be made -- that no differentiation is made as to whether this "housing" under consideration is new (included in gross national product esti-

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[1]"Economic Indicators", prepared for the Joint Economic Committee by the Council of Economic Advisors, 87th Congress, 2d Session, (Washington D.C.: U.S. Government Printing Office, June, July, etc., 1962).

[2]"Business Cycle Developments", Bureau of the Census, U.S. Department of Commerce, (Washington D.C.: U.S. Government Printing Office, December, 1962).

[3]Hitch, Charles J. and McKean, Roland N. The Economics of Defense on the Nuclear Age, (Cambridge, Massachusetts: Harvard University Press, 1960), p. 71.

mation) or not new. Pointedly, a slump in housing is a slump in housing. And to think that the slump will be restricted to new housing, so it can be measured for purposes of forecasting, is not realistic. In addition, it would appear that if the slump were in new housing then housing which is not new should be even more adversely affected.

Another encouraging fact the economic indicators report for January, which was given front page coverage in the Business and Finance column (first article) of the Wall Street Journal.[4] This story reported the sad news that home construction industry had "sagged" during January. The report had come from the Census Bureau which noted private housing starts were at an annual rate of 1,242,000 (seasonally adjusted), which was down from the previous month by some 15%, and was at the "lowest level since February, 1962." While a lesser decline could have been rationalized because of cold weather construction problems, this decline was more than had been anticipated. The same edition reported declines also in "January's work week, retail sales and personal income from private sources".

Finally, an assembling of reference data into this one source is intended to join the ideas of economists dealing with the business cycle and the real estate analysts concerning themselves with the real estate cycle. The bringing together and making available of this information and these ideas become an ancillary benefit of this thesis.

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[4] Wall Street Journal, Wednesday, February 20, 1963.

PART I -- THE BUSINESS CYCLE, A RESUME'

Chapter I -- Background

The use of the word resume' is utilized, because this is a general summary of background information on the business cycle. To do more than summarize would be difficult when one considers the voluminous detail available on the subject. Here we consider the business cycle in its four phases -- expansion, peak, contraction and revival. Many worthwhile volumes are written on one or another phase of this cycle.[1] Hence, to do more than sum up here would negate the value and effectiveness of this paper.

In September, 1930, the Assembly of the League of Nations adopted a resolution determining that an attempt be made to coordinate the analytical work then being done on the problem of the general occurrence of periods of economic depression.[2] It is interesting to note that the terminology of the period referred to "trade cycles", indicating the use of the term which was acceptable and utilized on the continent of Europe.

This period in time is noted since it was immediately after our own country's "Black Tuesday" of October 29, 1929, which triggered the Great Depres-

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[1]A classic example is John Galbraith's, The Great Crash, 1929.

[2]Original publication of Prosperity and Depression followed as a publication of the League of Nations in 1937. Subsequent editions were published containing revisions and additions. When the United Nations published its first edition of Prosperity and Depression from Lake Success, New York in 1946, portions of 1943 League edition were reprinted.

sion and eventually saw the whole world involved in an economic catastrophe of greatest magnitude. However, the period noted here (1930) simply emphasized the urgency of the search for clues to the never-ending riddle of prosperity and depression. The whole world wanted answers. But this in no way minimized the continuous search for information on the subject by economists, business men, heads of government, political figures and scholars the world over, whether depression or prosperity is the economic order of the day.

Earlier writers were aware of the dangers of agricultural famine in the most primitive of societies. Such famines threw the economies of the time into chaos, primarily due to their systems which lacked transport and storage facilities. These same earlier writers, still possessing little in the way of quantitative information or analytical ability to visualize depressions as inevitable phenomenon of the monetary economic structure, were paying disproportionate attention to the "crises" or "panics", as they were then called. These writers could not accept the fact that the periods of "boom and bust" were a normal part of our monetary system. Hence they termed "panic" the crises of 1837, 1873 ("Jay Cook Panic"), 1893 ("Cleveland Panic"), 1907 ("Rich Man's Panic"), etc. Later writers however, speak more in terms of prosperity and depression with the attendant peaks and troughs in between.

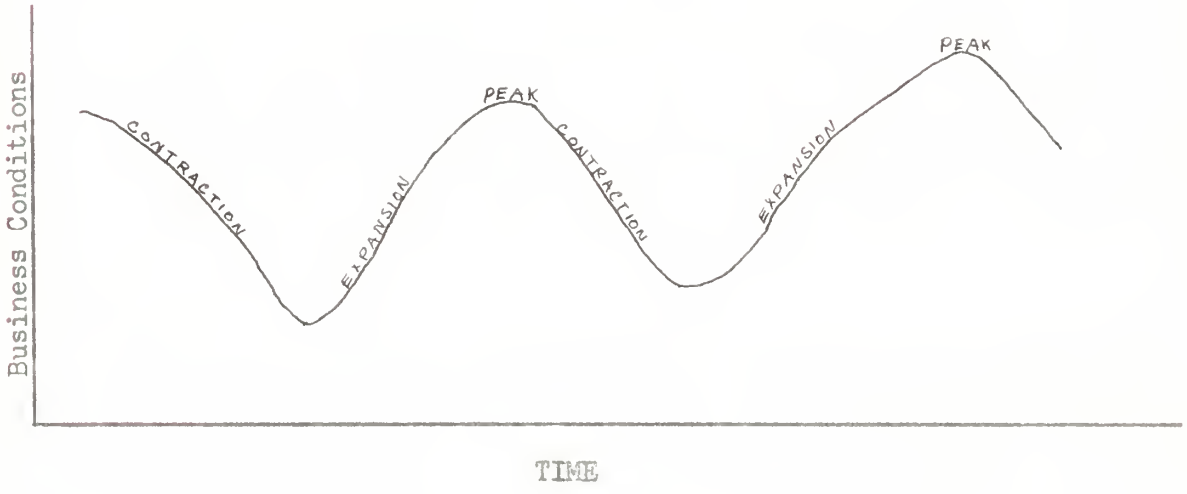
It is generally agreed that the four phases do exist. However, there is wide latitude between terms used to describe the phases. This difference in terminology results from "continental" terms such as one would expect to infiltrate the international publications prepared as United Nations documents in comparison with terms used by American authors. These differences pose no threat to understanding the cycles, however.

Examples of differences:

Newer Terminology[3,4]	Older Terminology[5]
Expansion	The Upswing
Peak	The Upper Turning Point
Contraction	The Downswing
Revival	Revival

This process of the business cycle indicating the cyclical expansion (the upswing), followed by periods of contraction (the downswing), with the turning points between can be graphically shown:

FOUR PHASES OF THE CYCLE[6]



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[3]Paul A. Samuelson, Economics, An Introductory Analysis, (5th ed.; New York: McGraw-Hill Book Co., 1961).

[4]W. C. Mitchell, Business Cycles: The Problem and the Setting National Bureau of Economic Research, New York, 1927. "Peak" has replaced his term, "Recession" because the latter commonly refers to a moderate dip in the economy lasting about a year or more in length.

[5]Gottfried Haberler, Prosperity and Depression, A Theoretical Analysis of Cyclical Movements (Lake Success, New York: United Nations, 1946).

[6]Samuelson, op. cit., p. 289.

Many economists attempt to tie down these cyclical fluctuations into periods of time. Some are of the opinion that the economic cycles are made up both of major cycles and minor cycles and so the question of how long or how short, rotates around the business determination of how many minor cycles one wishes to count. Most economists view the length of major cycles as approximately nine years. For example, if the point is accepted that the period of the 1920's be considered a general period of prosperity and the early 1930's be considered a period of depression, there would be agreement. However, in the 1920's, specifically in 1924 and again in 1927, (and the later-to-be-discussed real estate picture beginning in 1925), there were small downswings in business activity. This raises the problem of considering the 1920's as simply one large prosperity period or three smaller cycles. Other minor cycles have shown themselves since that time to further confuse the issue. However, the economists prefer to discuss primarily the major business cycles, and attach prime consideration to them.[7] The minor cycles are retained for accuracy, but are not of great importance.

Still other economists, preferring the huge historical approach to business cycles, speak in terms of "long waves". In doing so, one tends to move farther from purely commercial or business considerations into the area of historical considerations such as wars, inventions, disasters and discoveries. These long trends last approximately half a century. A classic example is the end of the Napoleonic Wars, with the defeat of the French at Waterloo in 1815 (by the British and the Prussians). Earlier the same year saw the last battle, New Orleans, of the War of 1812, between the Empire of Great Britain and the

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[7]Alvin H. Hansen, Fiscal Policy and the Business Cycles (New York: Norton, 1941).

fledgling United States. From a cyclical peak at this time there began a long downswing with accompanying price drops and hard times which were not to terminate until the middle of the nineteenth century with the historic event of the discovery of gold in California (and later Australia). The upswing was aided by the rising prices of the Civil War in this country and the Crimean War abroad. The end of the upswing came with the panic of 1873. Then the downswing began and lasted until the late 1890's, when gold was discovered in Alaska and Africa, and when the Spanish-American War took place. Discussions of these "long waves" still are not conclusive as to whether they should be considered as solely historic accidents or whether they may at some future date be beneficial in cyclical analysis.[8,9]

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[8] J. A. Schumpter, Business Cycles (New York: McGraw-Hill Book Co., 1939). In Chapter 6 and 7 the author refers to these long waves as "kondrateiffs".

[9] Samuelson, op. cit.

Chapter 2 -- The Phases

At this point we would do well to consider more in detail the four phases of the business cycle discussed in broad general terms in Chapter 1. There were the Expansion (The Upswing), the Peak (The Upper Turning Point), the Contraction (The Downswing) and the Revival.

We might recall some basic definitions. When speaking of nondurable consumers goods, reference is being made to such items as pencils, paper, pens, food, clothing, shoes, soap, cosmetics, cigarettes, cigars, etc. These items are not rapidly affected by a business cycle. The need for such commodities continues in good times and bad. On the other hand when speaking of durable goods (or capital goods) reference is being made to industrial machinery, plant equipment, automobiles, trucks, tractors, washing machines, and all types of industrial, commercial, and residential construction. As these observations indicate, the durable goods are rapidly (and violently) affected by the business cycle. Here then is a good departure point for our consideration. If the non-durable consumers are not bothered in a volatile way whether the economy is in a period of prosperity or depression, its close scrutiny will not appear to be of much assistance in analysis. However, as the durable goods portion of the economy does have wide fluctuations when the business cycle moves from one phase to another, then here is a possible barometer of value in market analysis. Looking at the problem from yet another angle, that of cause and effect, it

might be said that the use of nondurable consumer goods might be considered little more than an effect of the business cycle. But the use of durable goods (or nonuse of durable goods) could very possibly be one of the causes of the business cycle, or at least contribute to its presence. Analyzing the capital goods further they may be one of the symptoms of the state of the economy.

The intention in this portion of the paper is to expose the phases of the cycle and not go into the voluminous list of theories relating to the causes of business cycles. Here in passing is a brief listing of theories which could rapidly be increased by more additional theories or combination of theories. This grouping is effectively presented by Samuelson:[1]

"1. The Monetary Theory -- ties the swings of the cycle to the expansion and contraction of bank credit. (Hawtrey, etc.)

2. The Invention Theory -- credits the cycle to an assembling of a group of inovations or inventions at about the same point historically. (Schumpter, Hansen, etc.)

3. The Psychological Theory -- treats the cycle as a case of people's infecting each other with pessimistic and optomistic expectations. (Pigou, Bagehot, etc.)

4. The Underconsumption Theory -- which states that too much income goes to wealthy or thrifty people compared

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[1]Samuelson, op. cit. In addition to the authors mentioned by Mr. Samuelson in the discussion of the theories, another reference is Gottfried Haberler, Prosperity and Depression (4th ed., Cambridge: Harvard University Press, 1958).

to what can be invested. (Hobson, Foster, etc.)

5. The Overinvestment Theory -- attributes too much rather than too little investment causes recessions. (Mayek, Mises, etc.)

6. The Sunspot-Weather-Crop Theories -- claims that sunspots on the surface of the sun give rise to the business cycle. (Jevons, Moore, etc.)"

The business cycle, then, has been part of the economy of countries utilizing the monetary system for quite some time. The expansion phase might commence with a discrepancy between the natural and money rate of interest. How or why this development occurred is not the immediate point. For this example assume the money rate stands below the normal rate presently existing, thereby causing a credit expansion. Then assume that a price rise ensues. This can be better understood if it is recalled that a low interest rate tends to raise prices while a high interest rate tends to depress prices. In addition, rising prices tend to raise interest rates and falling prices tend to reduce interest rates. If prices rise and the businessmen anticipates a continuous rise, an eagerness will develop to borrow more funds and the demand for credit will become stronger and stronger. A reversal of this effect will be seen during a period of falling prices.

The expansion phase may be looked at in still another way -- consider the demand and the supply of loanable funds. Suppose that credit is available at the bank, lending institution, building and loan association, etc., as a result of the savings of the depositors of those organizations. The ability of these lending institutions to make this credit available means the supply of

funds for lending purposes is elastic and flexible, which is what one might expect under these circumstances. It would follow then, that as the demand for and supply of credit exceeds the supply of savings, a credit expansion could begin thereby prices would rise and as they do profits initially rise also. Now if more credit is demanded the interest rate will go up. As the prices rise even higher, profits continue to rise, inflation continues, and will keep rising until the momentum is halted by a considerable lifting of the rate of interest being charged by the lending institutions. Our consideration of the monetary aspects of the expansion phase need go no further (into the financial details) at this point.

Other factors are at work at this time, one of which is the structure of production. Consider production as having many aspects, such as the machinery used, tools, equipment, the inventories (be they raw materials, goods in process, or finished goods), etc. As production factors are modified or increased, more usually than not, the production technique tends to be pointed toward an increase in the output of consumers goods. However, the output or rate of flow of completed consumers goods (finished goods into inventory), is not as high as the percentage increase in the capital goods investment which has been developed during the time frame under study.

Still other factors are in operation. The general subject of savings and interest is mentioned here simply because the savings accumulated and available as the amount of income not used for purchasing consumers' goods can be considered for or made available as new investment. To attract new investment or to induce new savings to be offered, the return or profit on the savings invested must be greater than the prevailing rate of interest. That is to say, yield from utilizing the savings as investments must exceed the current rate of

interest or the savings will not be invested in this productive process. Numerous other theories, many of which are sound, are also working during the expansion phase, but these listed above will suffice for our consideration at this point.

The peak of the business cycle has now been reached. If a preference were to be stated, it would be for the monetary expansion and heavy investment to continue upwards, or at least to level off into a high plateau, rather than reach a crisis which our doctrine tells us will occur. The overinvestment theory, for example, states that a continuous upswing is not possible because by the continual lowering of interest rates, the economy could be following long round-about methods of production which could not be indefinitely maintained. More financial assistance could be made available to bolster the system but the over extension will eventually terminate the investment phase, causing loss of part of the invested capital. Sometimes if the upswing continues too long, without adjustments of any kind, the result could be even more aggravated.

An interesting aspect of this overinvestment theory is the ease with which comparisons are made to it. For example, the early Russian Five Year Plans hammered hard on this same delayed or detained approach to production to assure future consumption of consumers goods. In a nut-shell, by initially curtailing the production of such consumer goods as food and clothing to the barest essentials required, the Russians produced power installations and steel mills, attempted to improve the existing transportation system and assured that their production system would develop consumer goods only after a long drawnout period. This apparently was intended as an effort to bolster the economy and guarantee the upswing phase for an indefinite period of time. This is unusual for the U.S.S.R. who are more concerned with state policy than monetary consideration. In the pursuit of state policy the collective decision of the rulers

was carried out. The individual Russian consumer had no voice in this solution.[2]

Another theory concerned with the attainment of the peak of the business cycle is the idea of the shortage of investible funds. This could result from the instability or unwillingness of the loaners (banking system, savings and loan institutions, etc.) to assist in continuing the economic expansion. At this point the banking system, et al, are already heavily committed for the economic future. It is also possible that by now the production structure may have reached such a high point that continuous full production can be attained if other portions of the structure are adding to their ability to produce. For example, suppose an industry expands to meet the needs of other industries only to have the other industries stop expanding. To make the point, suppose the steel producing (or brick producing) industry has been expanding at full production in order to meet requirements for industrial construction steel (or residential construction bricks). Then if the need for construction steel (or brick) falls off due to adverse conditions within that field, the adverse effect will also be reflected in the steel (or brick) industry. If, at this point, the banks were considering key investments but decided to delay, it would be another indication of the fact that the peak had been reached.

The point should be clearly understood that while the term "shortage of capital" is being considered here, the term should be used with caution. Some theorists (the overinvestment school) would feel the problem is not solely a monetary one; they are correct in that the monetary measures cannot completely avert the peak, but can possibly postpone it. Even this is a dangerous consideration in that "galloping inflation" could set in so quickly during such a

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[2]Cf., Gottlieb Haberler, Prosperity and Depression (Lake Success, New York: United Nations, 1946)

period because if credit expansion is not stopped it could bring about a complete collapse of the monetary system. A classic example of this was the spread of German inflation in 1921-1923, until finally the German public was considering abandoning the rapidly depreciating currency, the German mark.

Another factor of varying importance is the economic results of faulty bookkeeping practices. This principle is based on the accountants' theory that the value of money (as recorded) is a constant thing. Inflationary times over extended periods have shown this to be in error.[3] As costs are continually tied to acquisition amounts, problems have developed because replacement costs of the original property, equipment, or machinery are greatly enhanced. If too little is written off, an enterpreneur sees a paper profit and capital is treated as income. This same enterpreneur, initially misled, may increase consumption.

There are other theories concerning the peak of the business cycle which are contributory but no requirement exists for their inclusion here.

The contraction phase is basically one of readjustment. The overinvestment school of theorists speak of the adjustment of the structure of production. Because of the boom period the extension of the production system takes place. As the economy contracts a reduction in expenditures of consumer goods takes place. This period of readjustment is painful and protracted. Workers at all levels of production are out of work. Retraining occurs within the ranks of the workers as they vie for the existing jobs. Some transfers from one geographic location to another take place to gain employment. This point, however is non-monetary in nature. Recognition of monetary influences is also necessary. The

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[3]Ralph Dale Kennedy and Stewart Yarwood McMullen Financial Statements, Form Analysis and Interpretation, (4th ed; Homewood, Illinois: Irwin, 1962), p. 433.

cumulative processes of contraction correspond to the previous cumulative processes of expansion and results in a shrinkage in the ag regate flow of money. This deflation concept makes it possible to more easily understand why the depression spreads to all portions of the economy. It is not confined to industries which are overdeveloped or overextended and as such must contract, but those industries which are underdeveloped and should normally be expecting to expand are adversely affected also.

It has come to be understood that the deflation cycle is related to certain maladjustments which the upward swing of prosperity has produced. But this in no way means the severity of the deflation will in any way correspond to the overinvestment ratio which produced it. Rather, the deflation, once turned loose in the economy tends to accelerate and continue by its own momentum and other factors. Some economists feel this deflation is the ultimate result of the boom, and as such is a sort of price one expects to pay as a necessary consequence. During the downward phase, or after the breakdown of the boom, a bank, for example, will not only stop expansion but will cease credit in order to enhance liquidity. Industrial firms also, to maintain strong financial reserves, will tend not to reinvest. Individual hoarding becomes a contributing factor. All these actions tend to permit money, the vehicle of real capital, to fail to perform at all in this capacity because it is tied up in any one of a galaxy of "saving" endeavors. A general price fall will further dampen any hope of early investment by financiers, individuals or corporations. An atmosphere of pessimism hangs over the troubled economy causing more worry and distrust. Within such an atmosphere the already serious problem is aggravated by ill advised discussions of Federal, State and local governmental intervention to keep up

prices, profits and incomes.[4,5,6]

The optimistic hope, of course, is that this is not a contraction phase of the business cycle, but rather a recession, a shaking out of the market. A peak dies hard, and numerous attempts are made during the contraction phase to detour the contraction simply into a recession, or lesser evil. A relatively recent example of the "keeping things going" approach was the announcement by the Federal Reserve Board that the Federal Reserve member banks reserve requirement for time deposits was being reduced from 5% to 4%. The announcement was made on October 18, 1962. The credit easing move then took effect at banks in the larger "reserve cities" on October 25, 1962, and at other member banks on November 1, 1962. The Board estimated the reduction would lower the banks' required reserves by $767 million, which officials calculated would expand their lending ability by some $4.6 billion.[7] (A certain percentage of these lendable funds certainly will make their way into the real estate field.) Another example is that of the Veterans Administration in paying the National Service Life Insurance dividends earlier in the calendar year than the anniversary date of the policy for 1961, 1962 and 1963.

The revival phase is one long awaited by the members involved in an

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[4]L. Robbins, The Great Depression (London: McMillan and Co.,Ltd., 1934).

[5]John Galbraith, The Great Crash, 1929 (Boston: Houghton Mifflin, 1955).

[6]Pearl Janet Davis notes: "By 1933 taxation, real estate's oldest problem, was to become critical. In one day one fourth of the land in Mississippi was put up to be sold for taxes. At the end of 1931 there were 40 million acres delinquent in five states alone -- Michigan, Minnesota, Oregon, South Dakota and Wisconsin. Four states then owned 16 million acres of land, 12% of their total area, by reason of tax delinquency." See Pearl Janet Davis, Real Estate in American History (Washington D.C.: Public Affairs Press, 1958).

[7]Wall Street Journal, Friday, October 19, 1962. Some Washington quarters anticipated this to mean the Reserve System intends to made sure that commercial banks are amply supplied with lendable funds.

economic depression. Yet the momentous instant of the revival may not be easily recognizable as having arrived. Nor is the revival a brief period. The monetary system, suffering from the depression, may only gradually return to equilibrium. The effective quantity of money is a key to the revival. The velocity of money should be interjected in just the right constant proportions so as not to upset the revival and turn it into a period of inflation. At this time also, the banks, in a more liquid position, should reasonably be able to comply with the increased demand for credit. Money will also be flowing into the investment market. A whole series of factors, some "internal", some "external" to the economic system may have had a beneficial contributory effect. The problem of "internal" or "external" factors is belabored by some in trying to rationalize the revival phase, as is the percentage of employment at the time of the revival phase. The point of the matter is that all factors play some part in first, bringing about the revival and second, by acting as symptoms so that the presence of the revival phase can be ascertained. The unemployed resources of the producers will be put to work. The activities of the production structure of the consumer goods will be accelerated. Demand for the consumers goods will increase. Prices need not go up initially, even in small encrements. Extension of credit can continue. A feeling of optimism is present in the market place.

In this chapter the phases of the business cycle have been discussed in terms of a broad overview. The same phases will be discussed in Part II as they relate specifically to the real estate field. Suffice it to say the discussion of the business cycle was intended to indicate its importance to this paper and to anticipate relationship between the business cycle and the real estate business.

PART II -- THE REAL ESTATE FIELD

Chapter 3 -- The Requirement for Housing and Homes

Early in one's educational background the basic needs are ascertained to be food, clothing and shelter. A starting point would be to determine the requirement for housing, remembering the term is used loosely and encompasses many types of housing. There are housing requirements for residential, commercial and industrial purposes. Studies indicate that approximately 40% of all totally developed areas are for purposes of residential use. However, some 90% of the real estate market has to do with buying, selling, trading[1] and financing residential properties. But it should also be remembered that there is an urgent requirement for urban properties to fulfill the needs for commercial and industrial concerns and for public use. Also, because of the high percentage of the market being involved in residential homes, that aspect of the field will be highlighted. The study of housing may be approached from two points of view: that is, the number of dwellings and the quality of those dwellings. The number of dwellings simply refers to the availability of facilities for living purposes. These facilities include areas for food preparation, eating, sleeping,

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[1] The Wall Street Journal, Monday, September 10, 1962, pointed up a recent trend of trading houses through the real estate broker when the house cannot find a buyer. This permits the seller to complete his move to a newer home and has tended to spurn an otherwise sluggish aspect of the market.

recreation, sanitation and cleanliness, with whatever degree of comfort which can be expected from the second aspect, quality. The quality of the dwelling has reference to the physical and economic characteristics such as its location, state of repairs, condition, size, appearance, internal and external arrangement, equipment, types of structure and price, or rent.

Also in laying the groundwork for the discussion, it should be remembered that while considerations and comparisons are being made on a national scale, the need and requirement for housing is local. That is to say a market for urban land will exist where normal forces of supply and demand are affecting the market in that local area. An example of this is the new modern dwelling constructed in the suburbs of a ghost town. Although the unit is a quality product fulfilling many of the requirements of quality listed above, size, equipment, etc., the fact remains that since the forces of supply and demand do not operate normally in this specific case, the demand for this residential housing unit will be quite low, if in fact any demand exists at all. As a result, it can be seen that the demand for housing and houses reflects the economic and social characteristics of the local community. And this local demand will also be affected by national (or regional) fluctuations.

As mentioned above, shelter has been and still is considered one of the necessities of our way of life. Living in an environment of possible adverse weather conditions, the shelter available to protect all age groups as they work or play remains a continuing requirement. As business endeavors increase, as industry expands and as population growth continues, the demand for these needs to be satisfied will be reflected in a demand for commercial, industrial and residential real estate.

A basic decision which every family must ultimately make -- whether to buy or to rent -- brings the question of tenure into sharp focus.[2] The price of a home is probably the largest single expenditure that a family will absorb. The decision rotates around the length of anticipated stay in the area, the cost, the terms of financing, existing economic conditions, the age of the decision-maker, and a galaxy of related considerations. Suffice it to say the gauntlet of reasons are considered not once but many times in the rationalization of tenure.

When the early settlers came to this country one of the unexcelled opportunities they found was that of ownership of land and homes. This had taken centuries to develop in Europe, but was available in this country from its beginning. An examination of the ratios of home ownership and its fluctuations due to prevailing economic conditions show how the percentage of ownership has grown -- from 1900 when the home ownership was 37% to 41% by 1920, and then to 46% in 1930. The adverse effect of the depression is reflected in the decline to 41% by 1940, then a steady increase to 47% by 1944, to 53% by 1947, to 60% by 1950, and 64% by 1960. Home ownership has become a mark of civic pride. Local communities report favorably on their home ownership percentage.[3] These figures tend to show which way the economic winds are blowing. In good times, when employment is high, incomes steady or rising, family savings increasing,

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[2]Seeing this situation from the Washington, D. C. area presents a distorted picture in that the frequent personnel transfers into and out of the area afford an environment which rapidly absorbs the attitude of tenure. In an area less knowledgable on the subject this is a major decision, faced less frequently.

[3]An example appeared in the South Bend, Indiana, Chamber of Commerce Report for 1962, when it was noted that the rate of home ownership in that community was 73% -- "among the highest in America".

values rising and the accompanying available credit, the decision to buy a home comes more easily. On the other hand, how difficult for the average citizen to make a decision to purchase when economic adversity is the order of the day, when unemployment rates are high, incomes declining, family savings depleted, future uncertain, values declining below the mortgage note total, credit difficult if not impossible to obtain, and the numerous other financial problems associated with such periods of strife. This particular type of time frame has a most undesirable effect on the economy in general and real estate in particular, because unemployment will tend to cause workers to depart from the hardest hit areas. Others will double up.[4] These and other factors will soon present a vacancy rate in all qualities of housing so that a falling off of construction activity will result, thereby compounding the economic woes.

There are times in the economic cycle when the decision to buy is hampered by the fact that homes are not available. A classic example of this was the World War II period, and its immediate aftermath, when housing shortages were critical. Here was a situation in which values rose exceedingly because the "input" of new housing construction was not accomplished because the war effort gave lower importance or priority to residential building than to war production. The impact of the shortages was noted in the increased values of housing.

One other word about tenure in the wartime conditions is appropriate. During the present century efforts have been made to protect tenants by means of rent controls. These are necessary and generally speaking, have been successful in preventing abuse by excessive rent increases. Although the authority has

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[4]Meaning to move into already occupied quarters, usually on a temporary basis.

lapsed nationwide, certain areas, noteably New York City, present problems of such magnitude that controls have been maintained on a local basis. The point is made here to emphasize the closeness of the problem of tenure (and the real estate field) with the overall national economic conditions, including wartime restrictions and opportunities.

Home ownership has become even more important as a heritage of this country. The possession of real property presents a certain element of social prestige. Today's requirement for multiple transfers by business men, military personnel, career and professional members tends to minimize the status of an individual as to whether he is an owner or a tenant. The opinion has been offered by several writers that the home, along with the automobile remains as an example of the most obvious consumption.[5] The social aspects of home ownership have often been recounted. Whether the where-with-all is present to buy in no way lowers the desirability to own. In good times and bad one survey after another reflects this opinion.[6] While this opinion flows on unchallenged, it should be realistically recognized that the tenant has conversely a similarly strong opinion. As the business man moves from one geographically located plant to another within the overall company organization his social status is not impaired by his decision to rent. In today's environment, a business, academic, military and professional member tenant maintains a social equality with the home owner.

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[5]The estimate has been offered that the home began replacing the automobile as the primary status symbol in the late fifties. Vance Packard, The Status Seekers, (New York: McKay, 1959.)

[6]Independent studies have shown that four out of five middle and lower income families "prefer" to own their own homes rather than rent. Reasons included are, "independence," "good judgment", and "like to fix it to suit self", Example: "The Urge to Own", Architectural Forum, November, 1937.

Home ownership usually falls into two age patterns. First the age group encompassing the newlyweds do not, as a general rule, prefer home ownership. Also included in this category are the senior citizens who in the twilight of life are reluctant to accept the financial and physical burdens brought about by home ownership. The lending institutions tend to confirm this point by their reluctance to approve home loans for persons in these two age extremes. The second group to be considered is the middle bracket, these found between the newlyweds and the aged. This is by far the best risk group for the lending institutions, and their attitude toward loan applications bears this out. This group has pre-school and school age children which has been one of their considerations in the home ownership decision. Their income is adequate. One comparison[7] showed that of 20,000 policy holders, the average American couple buys its first home when the husband is 32 and his wife is 29 and they have been married for 5 years.

In addition to the financial comments previously made, it should be noted that the potential home purchaser must be capable of maintaining an income of sufficient size to meet the home payments. Family savings should have accumulated to the point where a minimum down payment can be met, usually approximately 5% to 10% of the purchase price. These factors are as important to the home owner as to the lending institution. And any inability to meet future payments will present a financial burden which the owner may decline to accept, whether the economic conditions of the day are up or down. Breadwinners tend to buy homes

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[7] The Family Economics Bureau Study, Northwestern National Life Insurance Company.

in communities composed of people of the same income levels.[8] Therefore the percentage of down payment converted into dollar amounts will tend to rise as incomes become greater, although the percentage remains the same.

Included in the basic considerations of the tenure decision must be the inevitable discussion of costs to be incurred in renting versus buying. The tenant visualizes a large "profit" portion of his monthly rental going to the landlord. Yet the same man in purchasing his own home of commensurate value will find himself paying even more per month than he did as a tenant. The new home owner accepts an increased responsibility with his home. He will spend more on maintenance and repairs on his own place than did his former landlord. He also has realized a new standard of living which he will endeavor to develop. This is human nature at work.

Even though costs are higher, the average home owner will be able to enjoy certain financial benefits. Because he works harder to keep his property in a good state of repair, his maintenance costs are lower. There is an accrual of tax savings because the local property taxes and the interest payment on his mortgage note are both allowable federal income tax deductions. Investing in a home is very much like investing in a savings account or investing in an insurance policy, in that regular payments are a form of regular savings. The purchase of a home ties up the dollar equity of the investor in an item, the value of which fluctuates and therefore acts as a hedge against inflation. Each author who treats the subject points up the fact that the investment consideration is less important than the personal considerations of having a home as a necessary

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[8]William Whythe, Jr., The Organization Man (Doubleday Anchor, 1956).

enhancing of a desirability of a better way of life for the owner and his family. The personal consideration of happiness causes the investment considerations to be of secondary importance.

Even though renting and purchasing are the basic matter here, it is preferable to remember that there are other combinations of ownership possibilities, such as leaseholds. This system of holding a lease for exceedingly long periods of time, as in the case of ninety nine year leases, some of which are renewable forever. Philadelphia and Baltimore have such leasehold arrangements. The ground can be purchased and thereby transferred from leasehold to fee simple with the expense borne by the buyer. The same leasehold system is in effect in Hawaii. This is due primarily to the limited amount of urban land in that island state and the fact that the missionaries had been given large land gifts by the reigning monarchs during the 19th century. This leasehold arrangement keeps the large tracts intact, yet makes them available for subdeveloping.

Cooperative ownership or group ownership of property is another possibility. In the case of apartment houses or tracts (including plots for single family developing) the members own stock in the corporation and at the same time hold occupancy under a permanent leasing arrangement. Some of the cooperative apartments of the 1920s were not insulated against any possible adversity in the economic atmosphere and became infamous failures in the depression days of the 1930s. The popularity of the cooperatives, (called condominiums in three states), is on the upswing again. Within the last fourteen years the Edgewater Beach Apartment beside the famous Edgewater Beach Hotel on Lake Michigan in Chicago was sold as a cooperative to settle the estate of the former owner.

The subject of location cannot be overemphasized. However, financial limitations usually restrict the location available to the average buyer or

rentor. People tend to gravitate toward their equals in the social, cultural, academic or professional spheres. Within the financial limitations imposed people tend to live among their own kind.[9] Location also encompasses conveniences, proximity to shopping centers, churches, schools, parks and playgrounds. Utility services, pleasant neighbors, absence of obnoxious land uses or unwelcomed social groups are all requirements to be investigated.

The value of a home, either rented or owned, becomes difficult to determine. Usually considerations of subjective personal values are included. One man may be willing to spend more on a home because the family spends most of its time at home, or for similar or related reasons. Another man of equal economic status may be willing to spend less because of the relative unimportance he and his family attach to the value of the home. Other comparisons might be that for a single house one man of wealth may offer much more than another man of less wealth, again due to the values assessed by each as to the merits of the house in question. There are also geographic considerations and other rules to follow in arriving at specific conclusions.

This assessing of values and the continuing need for various types of analysis is conducted by developers, builders, owners, managers, and of course the various level government officials. The uncertain factor to be determined is the future needs of the community, state or country in the area of homes and housing. Consideration must be made of the consumer who is to make the demand contribution. Next must be the analysis of locations available. Cultural,

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[9]One author suggests on this point that there are recorded many cases of former slum dwellers who have moved into more spacious public quarters only to reverse themselves and move back to the slums because of the more congenial social life. R. U. Ratcliff, Urban Land Economics, McGraw Hill Book Company, New York: 1949.

economic and social considerations must be related to space available for future housing needs. The final result should be some considered forecast of future housing and homes requirements. Surveys and reports are also published by federal and local agencies in order to assist local planners in developing future housing projects as they are needed. Most of these efforts are, as one might imagine, in the area of low rent housing projects. The usual arrangement here is to present a double edge sword of providing housing for low income groups and to study areas of possible inclusion in slum clearance programs.[10]

To view more of the details of the requirements for homes and housing other factors must be analyzed. For example, in terms of increases in population, there is more to consider than births and deaths. Increases in population are also registered by new immigrants moving into an area for the first time. This could be compared to the migration of emigrants from that same specific local area. The balancing of these factors will present some form of norm or standard from which to depart. The immigrant may not actually add to the demand for living space, except to obtain housing within the existing facilities available yet already occupied.[11] And so it can be seen that the total demand is a quantitative measure in terms of the balance or aggregate of the requirement.[12]

There are two ways to look at the effect of a marriage upon the residential housing market. First of all the marriage should increase the demand, and yet the second point is that all newlywed couples cannot afford to obtain a

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[10]Slum clearance, public housing, and urban development, are included in the theme of "The Rockerfeller Report: A Dissent", Fortune (June, 1958).

[11]Known as "doubling up", or moving into already occupied quarters usually on a temporary basis. See earlier footnote.

[12]Cf. Ratcliff, op. cit.

separate home. This last point is particularly true during the contraction or revival of a business cycle. While it is an accepted practice by certain ethnic groups to move in with relatives until the family pocketbook can support a move to separate quarters, this procedure is the exception to the rule which speaks in the general terms and specifies that newly formed families tend to increase the demand for residential living areas. An example of this is expressed in the fact that beginning with the recovery period of 1934, there suddenly was a large increase in the number of marriages which was simply a wiping out of a huge backlog of postponed marriages since the depression's beginning. One source[13] estimated that in 1933, there was an accumulated marriage deficit of 794,000. There was no housing shortage after this period, in spite of the upswing in marriages. For one thing, postponed marriages during this time frame were spread over a number of years. Some postponed marriages were never celebrated. And finally the "normal" factors such as death and divorce which occur in both prosperity and depression, tended to reduce the housing requirements during this period.

The years 1931 to 1933 registered a low point in marriage rates. From 1934 to 1939, a normal marriage cycle was recorded. In 1940, with the presence of wartime conditions, the marriage rate accelerated, with a high point being reached in 1942. This marriage rate appears normal, as the country was enjoying prosperous economic conditions. Another consideration was the presence of the existing draft law and the ability to be excused from military service because of dependents. Once America became heavily committed to the war effort on a

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[13]Stouffer and Spencer, "Marriage and Divorce in Recent Years", Annals, November, 1936.

global scale the marriage rate took a decided reduction until the conclusion of World War II, when the readjustment period arrived.

In the above discussion it was noted that all marriages did not result in a demand for housing. In addition, whatever increase is recorded, it is a net increase which is continually being reduced by the factors of death and divorce (or separation). Each and every divorce does not reduce the demand for homes and housing because the home may actually remain in operation. This is especially true where children are involved. Another possible exception is the fact that the parties to a divorce may each require individual housing. Eventually one or both parties may remarry. These exceptions are valid. However, in a large majority of divorce cases the home is broken up as such, and the participants in the divorce are housed in other quarters.[14]

The death rate is four times as important as divorce in dissolving families. When death claims one of the principals of a marriage it may cause a reduction in the number of demands for housing. There are times when the survivor will move and other times when the existing homestead might be continued until the death of the survivor. The divorce rate is continuing upward. One of four marriages ends "on the rocks". This disturbing situation has been on the rise since the end of World War II, and reflects more the disturbing wartime conditions and hasty wartime marriages. Hopefully, the present post-Korean War period should find the divorce rate "holding the line" rather than evidencing a continuing upward surge.

One analyst has concluded that in periods of prosperity the marriage rate exceeds the dissolution rate from death and divorce. And conversely, in periods

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[14]The divorce rate like the marriage rate is a reflection of the changes in economic conditions in that divorces decline during periods of economic depression.

of depression families are dissolved at a faster rate than they are created.[15] It has been estimated that between the years of 1930 and 1940, in urban areas there were more than seven million families dissolved by death and divorce as compared with some ten million marriages for a net gain of only three million.

While population changes are reflected in the requirement for homes and housing, they are not proportionate. It has been recognized that the birth rate does not affect the demand for some twenty-odd years after the blessed event, when the new age groups are forming new family ties. Here then is another facet of the real estate barometer -- the ability to recognize an upward population trend and then to predict future housing needs. Just as the age distribution assists the military personnel planner to forecast rank and grade requirements, so the urban land planners can predict future housing requirements. Some historic examples of this are the large number of births between the years 1920 and 1925. They would require housing during the 1940 - 1950 period (and further aggravated the post war housing shortages) and the postwar (World War II) "baby boom" which will present an increased housing requirement during the 1965 - 1970 period.

Minor changes downward in the price for houses for sale or for rent will cause only a small increase in total numbers of dwelling units occupied either by an owner or a renter. Realistically, the average family which pays rent or a monthly payment must also think in terms of financing, utility, and maintenance costs so that the requirement is accepted for a single home. To carry the comparison further, it should be noted that a major change downward in rents and

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[15] The Real Estate Analyst (St. Louis: The Real Estate Analyst, Inc., October, 1937).

prices will bring much activity, especially among the renters who can change accommodations easily. In this case the major price reduction will tend to offer a greater quantity of housing needs being satisfied with no greater outlay of rent. A tenant if faced with an opposite situation, that of a quickly rising rental market, also has the freedom of movement, restricted only by the existing lease. In such a market the tenant would accept accommodations of lesser quality due to the rent increase.

The quality of a house has, of course, to do with the interior arrangement and represents to a high degree, the costs of the accommodations supporting the internal house plan. In addition, the exterior of the housing unit will apply whether or not quality will be a consideration. Houses and buildings are very much an expression of the feelings of the people and the times, and as such are a reflection of the era itself. Many a period had dated the architecture erected at that time. Compare the "old fashioned" front porch, from which the occupants could observe the activities of the street, with the privacy of the patio in the rear of the house of today. In addition, whatever the attitude of the times, only a small proportion of the population is capable of purchasing new homes at any one time. Compare the statistics of Detroit, in 1939, when some 10,000 new dwellings were constructed in that city to become part of the 415,000 existing units for an increase of 2.4%, and the nationwide statistics two years later (1941) when 715,000 new dwellings were added to the existing thirty million for the same identical increase of 2.4%.[16]

Cities can usually trace their growth to the important factor of immigration. Immigration might include only a single person moving into a community

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[16]Cf. Ratcliff, op. cit.

or an entire family. Immigration is seen in the move of single men into the automobile producing city of Detroit during the large growth phases of the 1920s and 1930s. Migration from throughout the nation also includes the movement of couples in their retirement age to California, and the more recent movement of retirees to Florida. The married couples, especially those with children, have an immediate impact on the demand for homes in that community, while the single person affects the demand for rooms and eventually will affect the local need for homes and housing.

The economic opportunities available regulates the velocity with which people migrate from farm and village to city. The route is from country to city in times of prosperity and from city to country in periods of depression. For example, the years of depression, 1931, 1932 and 1933, saw a decline in population in Chicago[17] and Detroit.[18] This same effect was felt nationwide in 1932.[19] Later it was found that in the late 1930s, and on through the war years this trend reversed itself, with resulting gains in city populations.

Depression periods and acute housing shortages result in a sharing of dwellings by two or more families. If unemployment increases and earnings are reduced, this system of "doubling up" continues. Normally this takes place among relatives where the necessary expenses are paid by one or more of the wage

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[17] Homer Hoyt, One Hundred Years of Land Values in Chicago, (Chicago: Chicago University Press, 1933).

[18] R. U. Ratcliff, The Detroit Housing Market, Michigan Business Report Number 4, Bureau of Business Research, (Ann Arbor, Michigan: University of Michigan, 1939).

[19] Agricultural Statistics, (Washington, D. C.,: U. S. Department of Agriculture, 1938).

earners (depending, of course, upon the number of wage earners employed).[20] In the years of 1934, 1935 and 1936, (in a sample of 203 cities) some 439,000 families (or 5.5% of all families) were classified as "extra families" or families which would prefer or need separate dwellings under more prosperous economic conditions, including increased earnings.[21] A repetition of this report occurred in the 1940 Housing Census, where 1.3 million homes (or 4.6% of all families) housed one or more additional families. Data such as this is beneficial in computing potential requirements for homes and housing. It should be further noted that there are some groups of people who, either by custom, race or economic necessity will continually present the "doubling up" situation. Many cannot afford separate dwellings, while some are inclined toward this type of living and are willing to sacrifice their personal privacy for the additional purchasing power that results from combining incomes.

The housing shortage also causes a situation of "doubling up". This was observed and recorded both during and immediately after World War II.[22] Also, the necessary lag in residential construction during this important post war period is sure to have increased the sharing of dwellings.

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[20]In one sampling of one hundred forty eight cases of shared dwellings, there was a son or son-in-law relationship which existed in some 65% of the cases. As a matter of fact, only 5% of the families were totally unrelated. The location of the sampling was Martinsburg, West Virginia. Laurence N. Bloomberg, Journal of Land and Public Utilities Economics, February, 1936.

[21]Works Progress Administration, Urban Housing (Washington, D. C.: U. S. Government Printing Office, 1938). See Table One of this report.

[22]By 1945 the estimate was 1.2 million. Veterans Emergency Housing Program, Hearings on H. R. 4761, National Housing Agency, March, 1946.

In this chapter an attempt has been made to discuss how families within a given income group proportion their expenditures. Uniformity might be approached among families of similar cultural backgrounds, family size, and age and sex distribution. Within each income group, the difference in the proportion of income allotted to housing depends upon subjective values developed. In addition, home owners will spend more on housing than renters of the same income, for an owner is more willing than a tenant to sacrifice in other areas in order to secure a dwelling which fits his needs and tastes, and will retain its quality and use value over the long period of intended occupancy. Newly married couples and senior citizens tend to prefer rental property, including a preference for apartment living, while the age group of couples in between prefer to own their own homes. Included with this preference is the added responsibility of increased expenditures to maintain the home as they desire and the added physical burden of care of the property. Children are a deciding factor in the tenure decision.

Chapter 4 -- Cyclical Fluctuations

Within the real estate field the housing market cycle is comparable to the business cycle. The same rhythmic pattern is present and may be discussed in terms of price, balance, volume and velocity. In the housing market, cyclical fluctuations occur in transactions regarding sales of lots, houses, rental income properties, mortgages made and foreclosures. Measurements also result from the levels of sales prices and rents, in production of subdivision lots and related dwellings, costs of construction and costs of operation and internal problems relating to volume of vacancies, overcrowding and doubling up. Many phenomena are reacting, some internal to the housing market, some external to the housing market, with varying relationships to one another. The magnitude of these relationships each working as a part of the whole composite grouping which will determine the severity of the cycle. While the overall sequence of the cycle is predictable (and will be discussed next), the length of the housing market cycle or the overall effect is difficult to forecast. But recognizing its presence, it would appear to be only an academic discussion as to its significance as a barometer or indicator of the business cycle. The housing market cycle is important, as its impact is immediately felt and is a reflection on the economic stature of national business conditions. This impact is felt by individuals, corporations, as well as by local, state and federal governments. The housing market cycle is not only subject to the phases of the business cycle, (as

discussed in Chapter 2), but is a durable goods commodity characterized by volatility and undue length. In many ways the housing market is a reflection of the nations everyday affairs. For example, one of the largest single purchases the average person will make in his lifetime will be his home. A sudden contraction of the business cycle is reflected in the housing market and thus brings the problem face to face with the home owner. The national wealth or cumulated savings are manifested in housing. Huge income and expense transactions are reflected in the construction and building industry. Over an extended period, the average consumer will spend more on his home than on any other item, except possibly for food. In addition the effect of the cycle on individuals and corporations is measured in terms of success or failure, solvency or insolvency, profit or loss, wealth or bankruptcy.

The sequence of events in the housing market cycle can for the sake of our consideration begin in a "normal" condition[1] where a balance of market factors is present. If the expansion phase is to be visualized, it could commence with a basic increase in demand for housing by a number of families or by an increase in income or a combination of the two. Initially, about all that will be accomplished is that existing vacancies will be absorbed as undoubling occurs or as families take advantage of their increased purchasing power. As the remaining vacancies are reduced in number the price or rent of the remainder of these vacancies will be bid up. Property owners are more secure because their monthly payments are fixed, but the renters feel the rise immediately. Also, property owners find their investment appreciating in value should they choose to sell or rent. As far as rental property enterpreneurs are concerned,

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[1]For a good presentation of the real estate cycle see Hoyt, op. cit.

an initial increase in rents will leave operating expenses, such as utilities, taxes, etc., in the wake. This phase will see increased activity in the building of homes because the construction industry has been attracted by the higher sales prices and larger rents than anticipated. This initial impulse of interest in building is reflected in all types of construction, since many builders specialize in their own preference, plus the fact that home owners and rental property investors are attracted into activity.

The market moves along faster now, as the lending institutions, banks and savings and loan associations offer readily available credit to keep their funds invested and to repay the depositors. Other market conditions remain favorable, thus giving forcasts that this is a healthy move toward an increasing economy. Single family homes of upper and middle value are selling strongly. This surge has brought more interest to the activity in the form of some homes being kept off the market but rented instead to enjoy the higher rents available. More rental projects, including planned apartment construction has had time to be planned and developed. Lower income skilled and unskilled workers are now enjoying the benefits of wage increases and have moved into better houses or rentals, thus bolstering the housing market. As the building boom swells, it encompasses land subdivision, especially if the acceleration appears to be a prolonged one.

The occupancy of vacant quarters created by moves into new homes or rentals will continue the chain reaction until increased activity within the real estate field is noticeable. Moving "up" is reflected throughout the market. Each of these chain reactions leaves a vacancy somewhere along the line. However, as previously pointed out, the demand for housing comes from numerous

directions and a complex of factors is at work over the related period of time. In addition, there could be slum clearance programs, urban renewal programs, public buildings projects going on at the same time. These latter activities would be exercising the government's power of eminent domain to remove housing from the market. Besides these governmental agencies at work, commercial enterprises are constructing projects in keeping with their own plans and in consonance with the general favorable conditions. With the economy's expansion, industrial concerns are taking advantage of the upswing to enhance their productive capability by investing in plant expansion. Both these endeavors, commercial and industrial expansion, cause more activity in land and property acquision.

As the building and construction activities continue, the impetus of the endeavor may carry beyond the demand. Demand for homes, having been satisfied with the enormous chain reaction, may have slackened or dropped off. This would be particularly true in a situation where a general business cycle peak has just been passed. A decline in optimism causes potential home owners to hesitate the completion of transactions; they even cease looking. The same applies to the potential renter. This will cause a build up of vacancies in residences for sale or rent. Investors and speculators who entered the market during favorable conditions may sell at lower prices or consider renting houses which were constructed to be sold, but for which buyers could not be found.

The increased activity within the building trades up to this point has been most favorable. Besides employment being at a very high level, there has been a general price increase all along the line by suppliers, builders and enterpreneurs. Profits have also increased and thereby maintained incentives.[2]

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[2]Board of Governors, Federal Reserve System, Postwar Economic Studies No. 6. June, 1946.

Because of this, the price increases are rapidly passed along to the consumer, (the ultimate buyer), or else absorbed at one or another of the stages of construction. For example, in a housing development the first group of homes may cost "x" dollars to construct. If the costs continue to rise as the building continues, then the last group of homes in the project will have been higher ("x" plus) than the original ones. Other alternatives are to reduce costs by reducing quality or else by increasing the price to the buyer. As resistence to the increasing prices is reflected by potential buyers, the margin between operating costs and prices will be squeezed, driving marginal builders, subcontractors and speculators out of the market. The prices being asked become shaky in response to the growing vacancy rate. Lowered prices then are used to produce an upswing in both sales and rentals. Builders, however, run headlong into mounting construction costs. Overbuilding results are obvious. Substantial vacancies exist in both residential and rental units. Building costs may stop rising or even decline, but profit taking in new rentals has so declined that no new rental construction has taken place. This rental phase requires large capital investment, plus an extended planning period, and under these conditions it is too late to develop either. Some apartment rental building starts may be cancelled.[3] New demand is not forthcoming as an atmosphere of caution is presented. This atmosphere of caution in the presence of declining prices of houses for sale and declining construction costs has, in the

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[3]"New York City Moves into Building Slow Down after Post War Surge", The Wall Street Journal, Wednesday, March 13, 1963, reported with a front page story that where formerly a high rise, high quality apartment building could be totally rented in three months it was now taking nine months to a year and some buildings still had a 10% vacancy rate.

light of the mounting vacancy rate, caused a psychological block to investors. Potential home owners hesitate on their own or as a reflection of hesitancy on the part of the lending institution. These same lending institutions witness defaults by mortgagors who overbought, either by exceeding the proportionate share of their income which they should have paid for the home, or else they paid a watered price in excess of the value of the home. If at any time during this peak there are related factors such as a business recession, the depressive qualities of the housing market cycle will be aggravated. For example, in a small community supported primarily by a single industry, if widespread layoffs occur with many workers thrown out of work at once, the local housing market would immediately suffer. This points up the local nature of the housing market. If the business cycle is suffering a contraction period, all the factors discussed in the preceding chapter regarding movement from city to farm, doubling up and deferment of marriages apply. These factors minimize requirements for housing and when accelerated by such interrelated events as deaths and divorces further reduce prices and rents.

At this point in the possibility under consideration, the contraction phase, has brought a very high rate of vacancies, both rents and prices are greatly reduced, low construction rates, credit tight, transactions at a minimum, and high rate of defaulted mortages. The gauntlet of the revival in which the above factors are at rock bottom, including rural and urban property, has yet to be run before the expansion phase can begin. This end of the housing market cycle has now taken place. Accurate estimators have observed that the period from peak to peak is seldom less than fifteen years.[4] This apparently lengthy

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[4]Arthur M. Weimer and Homer Hoyt, Principles of Urban Real Estate, (New York: The Ronald Press Company, 1939)

cycle is a reflection of the complicated, costly commodity under consideration, one which takes long to produce and even longer to consume through use.[5] Is it any wonder the long up-hill recovery period is prolonged and painful and the contraction is rapid? Due to the interwoven complications involved in the lengthy production period in which contractors are working in numerous directions in a local geographic area, a sudden overbuilding occurs, with the related vacancy rate being magnified almost overnight.

The previous comments in this chapter on the theoretical approach to the housing market cycle is followed by the most recent historical example available. To summarize, the period between World War I and World War II, will make the point. The termination of hostilities of World War I, brought with it the end of wartime construction restrictions. The real estate market, however, was at rock bottom, sales were down, building was at a minimum, war facilities construction had driven costs upward, migration to the cities was reducing vacancies and raising prices and rents. These increased rents caused a flurry of building activity. Oddly enough, the overall business recession which gripped the country in 1921 and 1922, was preceded by a slump in residential construction in 1920. This proved to be of short duration. The dropping off in building activity in 1920, and the business decline which followed in 1921 and 1922 brought construction costs down, lowered prices and softened rents.

A real estate boom ensued between 1922 and 1925. Sales were up, numerous transfers were recorded, costs rose in construction[6] and were accompanied by an

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[5]As the saying goes, "More houses are torn down than fall down".

[6]This was just as true forty years later when the Wall Street Journal (Monday, September, 1962) reported, "Huge housing demand has triggered a steep climb in construction costs." "The pay of construction workers averages $3.23 hourly, 84 cents above the level for all factory workers and nearly twice what the average retail store employee makes. The $3.23 rate is $1.10 higher than the 1952 average for construction workers, a much larger gain than in any other wage category over the same period."

increase in rents and prices. By 1925, mortgages made and real estate transfers reached a peak, but the same year saw a rise in the foreclosure rate. A symptom of an ailment had presented itself. Only time would tell whether these foreclosures were the result of isolated cases of overbuying or whether the problem was more basic than that. The latter proved to be the case. While the housing market decline was continuous from 1925 to 1933, the more noteworthy fact is that due to its environmental and complicated make up as a durable consumer goods, the real estate market gave a forewarning of the economic chaos begun on Black Tuesday, October 29, 1929. Here was a symptom of a problem area which extended far beyond the housing market. As the decline progressed steadily from 1925, prices and rent level continued downward, building activity was reduced and foreclosures continued to increase. The favorable outlook in other business ventures, as reflected in the stock market in the years 1925 through 1929, did not pull the housing market cycle out of its contraction phase.[7] When the stock market crash occured in 1929, it aggravated an already unhealthy condition. Between the crash and the year 1933, the housing market and the business cycle both made their way to rock bottom.

The recovery from this valley of revival was slow but steady. All during the remaining years of the 1930's the building industry saw increased activity. Rents and prices rose in small increments. Foreclosures were checked,

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[7]The results were quite the reverse. Investment money was turning from real estate to the frenzied stock market. Declining commodity prices and declining building volume both tended to lower the general economy. Later analysts would note overproduction, installment buying, tariff revision, and technological employment would be pinpointed as contributory causes of the crash which followed. See Davis, Pearl Janet, op. cit. p. 165.

primarily by government intervention through legislative action. Building costs were rising as the economy went through the initial stages of this expansion phases. The country witnessed the rise of the European dictators through the 1930's, and the omnious conclusion as Europe broke out in World War II. This country's pre-war preparations saw increased activity in the real estate field. The war economy of this country saw the enactment of rent controls by the Office of Price Administration. This resulted in the control of costs, wages, and other items both related and unrelated to the housing market. The OPA remained in operation until the post-war period when its authority was reduced and finally lapsed.[8] Construction was limited to specific projects such as war factory and plant construction, and related housing projects in war production areas. In the early war years construction was intense but slowed down considerably the last two years of the war. When the country was plunged into World War II, there was initially a feeling of uncertainty due to moving of families to war manufacturing centers, and males being called to wartime service. There was a minimum of activity in the real estate field. However after a year and a half of wartime effort the die was cast and housing sales, rentals and transfers began to rise rapidly. The increased activity then caused shortages in housing which would decrease the vacancy rate.

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[8]Some rent controls, as mentioned earlier, will be in effect for some time to come in areas such as New York City, where critical shortages of rental properties makes this necessary. See William Nickerson, How I Turned $1,000 into a Million in Real Estate in My Spare Time, (New York: Simon and Schuster, 1959). A recent example of the need for rent controls was highlighted in the notice in the Wall Street Journal note (Monday, September 24, 1962) stated the rent a New York City project advertised for "lower middle income" families a typical two bedroom apartment for $230 monthly, --- far more than the traditional "quarter of your income" advised for renters.

The termination of hostilities in 1945, further increased the pace of housing activity. This was brought about by the returning veteran and the upswing in marriage rates. The latter was due to normal conditions, returning servicemen and marriages which had been postponed due to the war. Home purchase legislation ensued favorable to returning servicemen and included minimum down payment and minimum payments for extended periods. The immediate post-war period saw a continuous pressure upwards. Rents inched upwards as price controls were reduced. Costs rose as did prices. Construction activity greatly increased due to the immediate demand and the fact that building activities had been greatly curtailed the last two years of the war. A material shortage ensued which stopped some projects cold and extended the building time of others. These construction material shortages also produced illegal procedures and prolonged the price controls.

To sum up the activities from World War I to the post World War II period, there can be seen the wide fluctuations in both price levels and housing activity. This instability is normal in the housing market. It is difficult for a person unaware of the low ebb in the real estate field to comprehend the danger therein. Unless a person is aware of the historic picture back in 1925, there are risks considering only the fact that prices have been continually on the upgrade since 1933. There are others inclined to consider that this period of doldrums may never be witnessed again. Some forget the relativity of value. In the housing market we see a classic example of the basic forces of supply and demand at work. The construction industry can be compared to a production or manufacturing business which makes a product to be sold, not to be held for lengthy periods as an investment. As long as these forces of supply and demand are balanced one against the other the whole field is on solid ground. But to

have these forces out of balance invites catastrophe. One source[9] to this imbalance came about immediately after the first World War, when the construction industry built too many one-family dwellings at a time when rentals would have been more appropriate. Having overbuilt initially to the point where these homes could not be sold but were being rented, thereby reducing the need for rentals, a flurry of construction activity began in the area of rentals, with the building of huge apartment buildings, due (among other reasons) to ease in selling mortgage bonds to finance the construction.

An interesting graphic presentation of real estate activity and real estate mortgage activity is shown in Figure 1 as a comparison with the business cycle fluctuations. This particular one[10] clearly shows the downward trend from the peak in 1925, which was a business precurser of the crash of the stock market in 1929. As discussed earlier, this was thought to be a local real estate problem and not a sign of any financial problem that might encompass the whole of business activity.

Another presentation from the same source[11] (Figure 2) shows a comparison of the Dow-Jones industrial average of common stock with the selling price of a typical single family residence. This particular portrayal shows how, commencing in 1925, funds were attracted away from the real estate market into the more lively stock market. This aggravated the real estate problem at that time. Also indicated is the fact that it took twenty years, from 1925 to 1945, for the real estate market to recover. This means the field of real estate headed for the doldrums four years before the "crash of '29" and did not regain its former position until the termination of World War II.

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[9]Richard U. Ratcliff, op. cit.

[10]Real Estate in 1963, a forecast for subscribers to the Real Estate Analyst, Roy Wenzlick Corporation, St. Louis, Mo.

[11]Ibid.

Real Estate And Real Estate Mortgage Activity

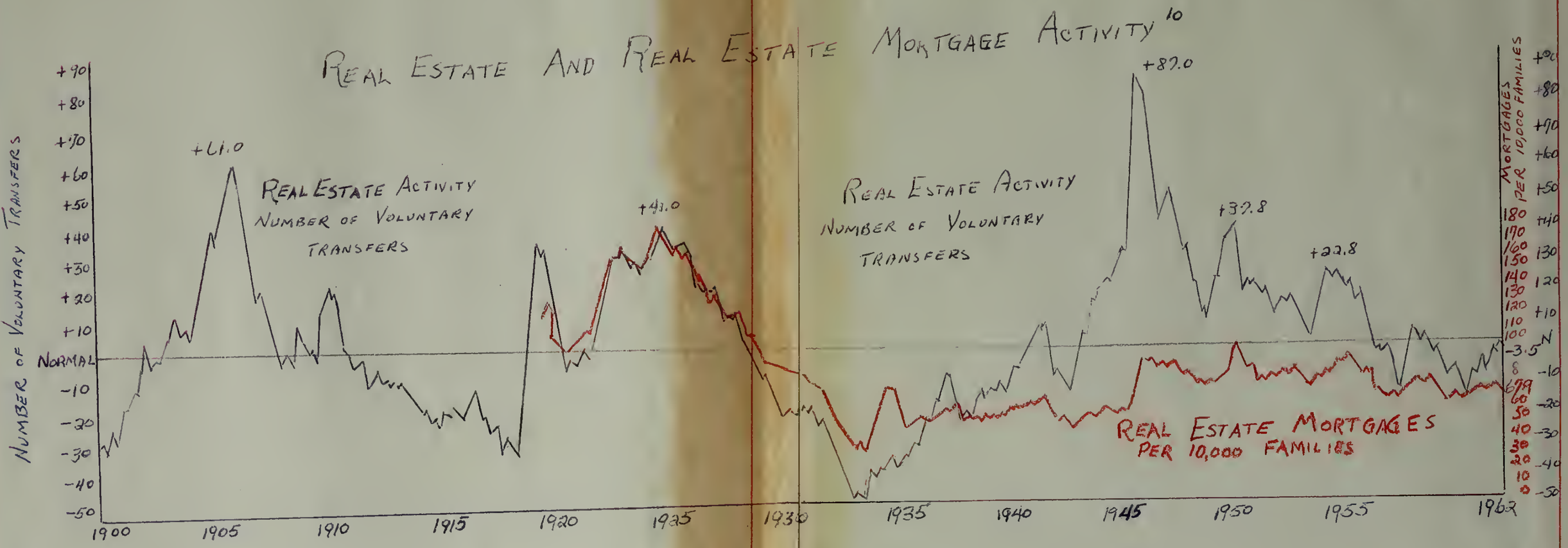


Figure 1

A COMPARISON OF THE DOW-JONES INDUSTRIAL AVERAGE
OF COMMON STOCK TO THE SELLING PRICE OF
A TYPICAL SINGLE FAMILY RESIDENCE



Figure 2



Chapter 5 -- Influences of Governmental Intervention[1,2,3]

Why should there be governmental intervention in a country which prides itself on a free enterprise system? Housing problems, historically, have been considered as local problems. During emergency or war-time conditions the state government might intervene to prevent profiteering by enacting rent control measures, as they did during 1917-1918 in Maine, Massachussetts, New York, Nevada and New Jersey. Many city municipalities also enacted rent control measures in World War I, because they were immediately affected adversely. The federal government intervened to protect the dependents of servicemen by enactment of the Soldiers and Sailors Civil Relief Act of 1918. These examples of intervention were for the general good of the country and for the specific benefit of its citizens.

Housing problems, per se, vary according to location, use and size of the community, and have been reduced by one reference to:

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[1]Cf. Philip A. Benson, Nelson L. North and Alfred A. Ring, Real Estate Principles and Practices, (Fourth Edition, Englewood Cliffs, N. J.: Prentice-Hall, Inc.), 1954

[2]Cf. Nelson L. North and Alfred A. Ring, Real Estate Principles and Practice, (Fifth Edition, Englewood Cliffs, N. J.: Prentice-Hall, Inc.), 1960.

[3]Cf. The FHA Story in Summary, 1934-1959, (Washington, D. C.: Federal Housing Administration.)

1. Blight and slum areas and their undesirable effect on health, housing safety and morals.
2. Low income family groups and their inability to secure housing facilities.
3. Need for adequate home financing facilities, policies and practices.
4. Protection against loss of home, tenant eviction, rent profiteering during periods of housing shortages or war-time emergencies.[4]

Any one of these problems (or group of problems) usually will be found at the root of an undesirable community housing situation. Local, state or federal laws pertaining to housing are usually made in an attempt to bolster or improve the conditions presented by these problems.

To answer the question concerning the need for governmental intervention, some of the ideas presented earlier should be called to mind.

The housing industry had enjoyed progress until 1925. Up to that time, housing for rent and sale was being built faster than ever before, and mortgage funds were available in amounts limited to a small percentage of the assessed value of the property. Lenders considered home mortgages as sound investments and it was felt the borrowers were well protected. As the foreclosure rate went up commencing in 1925, it appeared the problem might be a local one within the housing industry. But when the stock market crash of 1929 occurred, the

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[4]Cf. Philip A. Benson, Nelson L. North and Alfred A. Ring, op. cit., p. 414.

dismal economic outlook, of which the real estate field was a forewarning, was confirmed. Instead of following the usual system of granting renewals to short term mortgages as they became due, the lenders chose to demand payment to insure a position of liquidity. When the owners of the properties found on the one hand the lending institution wanted repayment and on the other hand their employment income had been terminated or reduced, an impossible situation faced them. When foreclosures were completed the lenders often found that the properties taken over proved to be worth only a small fraction of the debt the properties had secured. Indeed, some could not be sold at any price. This was due primarily to the exceedingly poor economic conditions of the time. As the foreclosure rate went up, the rate of building went down and unemployment in the construction industry and building trades went up. In this dismal atmosphere of the period it was apparent the only possible solution would be governmental action of some kind.

The federal government first entered the housing field at the close of the year 1931, when President Hoover called the President's Conference on Home Building and Home Ownership. The 3,700 conferees made a good cross section of the various aspect of housing and the housing industry. The following recommendations were made:

1. A broadened home ownership.
2. A system of home credit for better protection of home owners and lending institutions.
3. Improved planning and zoning.
4. Better homes at lower costs through improved technological process.
5. Rehabilitation of old homes.

In addition, the conference endorsed the President's proposal for a system of home mortgage discount banks to make mortgage money available and to encourage sound home financing practices. This proposal led to the enactment of the Federal Home Loan Bank Act (of July 22, 1932), which set up a home loan bank system patterned on the Federal Land Bank system, and authorized to make advances to member home financing institutions secured by first mortgages. Although the legislation was sound, its influence did not spread fast enough to prevent a rise in the foreclosure rate nor the rapid increase in unemployment. Initially the savings and loan associations were the only institutions to become members of the system.

Next came the Emergency Relief and Construction Act (of 1932), which authorized the Reconstruction Finance Corporation to make loans to corporations which were formed to provide housing for low-income families or to rebuild slum areas.

Up to this time the Hoover Administration had avoided interferring with home financing. Franklin D. Roosevelt won the national election in 1932 (November) and by the time he was sworn into office on March 4, 1933, the situation had become acute. During 1933, nonfarm real estate foreclosures had reached a new record of 252,400, and housing starts were only 10% of what they had been in the 1925 record year, when 937,000 homes were started.

The Home Owners' Loan Act became law on June 13, 1933. This put the federal government in the home mortgage business. This act formed the Home Owners' Loan Corporation to help distressed home owners by refinancing their mortgages with new five percent fifteen year amortizing loans. Between 1933 and 1936, when its loan authority expired, this organization took over more than one million home loans. In addition, the HOLC provided for chartering of federal savings and loan associations and broadened the credit activities of the Federal Home Loan Banks.

Next was enacted the National Recovery Act (of June 16, 1933) which authorized the use of federal funds through the Public Works Administration to finance low-cost and slum clearance housing and subsistence homesteads.

Up to this point however, each federal law enactment was to combat special areas of the real estate crises. An all purpose panacea to serve as a cure-all still had not been found. The housing industry needed help. Mortgage money was still frozen. Two million men in the construction industry were unemployed, and existing properties needed maintenance. Yet funds for repairs were not forthcoming. Lending practices were faulty. Knowledge of markets was inadequate. There was no organized building industry. This housing problem was still the core of the early 1930s depression woes. Discussions of possibilities continued through 1933. In 1934 the National Housing Act became law (June 27, 1934). This important legislation had four main provisions:

"1. Insurance against loss on property improvement loans.

2. Mutual mortgage insurance on homes and low cost housing.

3. National Mortgage Association.

4. Insurance of Savings and Loan Accounts."

At a time when the country was just beginning the slow climb out of its worst depression, the job of the Federal Housing Administration was to sell property owners on the idea of spending money for repairs and improvement even if they had to borrow to do it. At the same time the FHA had to convince the lending institutions to consider lending consumer credit loans up to $2,000 in amount, without collateral, co-maker or endorsers, with repayment extended for as long a period as five years. This arrangement was practically unheard of in banking practice at the time. Less than one percent of the banks were organized to make this type of loan when the Better Housing Campaign began, on August 9,

1934, with a goal of making the country aware of the benefits of the new program. And when all else was said and done it must be acknowledged that relatively few people understood the capabilities and limitations of the Federal Housing Administration itself.

The results of the Better Housing Campaign were instantaneous. By the end of 1934, there were no unemployed contractors nor building tradesmen in sixty different cities. By this time also, almost "4,000 financial institutions, representing more than seventy percent of all the commercial banking resources of the country, had FHA contracts of insurance when 1934 ended, and nearly 73,000 property improvement loans had been made. By December they were being reported at the rate of $396,000 a day".[5]

It should be noted that beneficial governmental interference such as exhibited here brought few outcrys of objection. This is another example of how some of our countrymen tend to use the complaint -- an infringement on individual freedoms and drifting toward the welfare state -- as a crutch of objection without first considering the proposal under consideration as being good for the country. In short, here is an example of governmental intervention which materially helped the country by helping its citizens overcome a problem too big for them to overcome as individuals. Husband and Dockeray put it like this; "Prior to the thirties, it was assumed that this" (attracting any form of capital) "was strictly a matter of decision by a free market; today the banking of governmental credit or regulation is often regarded as a necessary force of secondary protection."[6]

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[5] The FHA Story in Summary, 1934-1959, op. cit., p. 9.

[6] William H. Husband and James C. Dockeray, Modern Corporation Finance, (Third Edition, Homewood, Illinois: Richard D. Irwin, Inc., 1953), p. 286.

One manufacturer reported the interesting fact that of every six dollars spent for repairs only one dollar was borrowed, indicating that the rest was paid in cash. Here was a healthy sign to be witnessed in the depression. Estimates of modernization and repair work totaled in excess of $210,000,000 for 1934. These figures help support the fact that 750,000 people were employed during this period. All these statistics attest to the immediate acceptance of the law which was passed just six months previous, on June 27, 1934.

So much for improvement loan insurance. But negotiating a successful system of mutual mortgage insurance was yet another problem. Although initially viewed as a possible cure to the housing emergency, its long range effects could be visualized as more important. The fact remains that the mutual mortgage insurance was to effect a reform of existing practices and procedures in home financing. Each individual home financing transaction had been required by the law to be sound and the senior officer of the FHA, the Administrator, had been given the responsibility for determining the financial and economic soundness. This responsibility was acknowledged and manifested in the systems developed for new means of risk rating; standards had to be developed to ascertain soundness of properties.

A valuable norm to ascertain the borrowers ability and willingness to repay the proposed debt had to be developed. This latter point was the key to the whole problem. How could it be known whether the income and saving capacity of the mortgagor was sufficient to safely maintain payments until the mortgage loan was paid in full? How could a computation be made of the borrowers ability to pay, not only the present payments but payments far into the future also? And if the amount of the funds to be borrowed was to be a certain percentage of the appraised value, how could this occur on a national scale with no existing

standard system of appraisal available on a nation wide basis? Each of these problems could have been insurmountable because of the controversy involved due primarily to lack of understanding of the issues.

Another objection occurred when it was found that many local state laws existed which forbid lenders to take full advantage of the National Housing Act. There was then prepared a "model enabling bill" which was offered to the states for adoption. All states had passed some form of law by the end of 1937, to permit mortgagors within the individual states to take advantage of the new federal legislation.

The housing market and housing conditions left much to be desired because reliable information was not readily available on a national scale. The law provided that, "such statistical surveys and legal and economic studies as he "(the Administrator)" shall deem useful to guide the development of housing and the creation of a sound mortgage market."[7] So effective were the results that eventually the statistics developed became the best material available in the housing field.

There can be no question of the beneficial effect to the national economy in the 1930s of the governmental endeavor in the field of housing markets. Husband and Dockeray, speaking about overall governmental intervention (housing and other), notes, "....the government extended aid and created controls -- both by the request of private business leaders and by the force of election mandate."[8]

Although the National Housing Act itself has been amended fifty eight

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[7]48 Statutes 1246, 12 U. S. C. 1702 as amended by subsequent acts of Congress.

[8]Husband and Dockeray, op. cit., p. 4.

different times, the four principal functions mentioned initially as objectives, remained basically the same. (Some of the amendments will be discussed in detail later in this paper.)

The year 1935 was the first full year of operation and the resulting statistics are noteworthy, especially for a depression year, "....more than 708,000 property improvement loans with net proceeds to borrowers totaling $229,000,000. had been reported for insurance. Employment in the building trades was 10 to 15 per cent higher than in 1934." "Home mortgage insurance got under way and 23,400 mortgages totaling $94,000,000. were insured during the year."[9] This favorable rate of progress continued in succeeding years. By 1936, some insuring offices had already reached the point where revenues were already equal to expenses. And July 1, 1940, is a red letter day because by that time the entire organization could pay all expenses out of income; a self-sustaining ability which has been maintained to this day.

Noteworthy amendments to the original Act are as follows:

a. Revision of Title II to provide for more liberal terms on new low cost, owner occupied homes -- 90 percent mortgages with maturities up to twenty five years (1938).

b. The Treasury guarantee of FHA debentures was made permanent (1938).

c. Extension of property improvement loan insurance has been restored from time to time by extensions.

d. Revision included the opportunity to use the act for construction of houses for profit.

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[9]The FHA Story in Summary, 1934 - 1959, op. cit. p. 12.

e. A special provision was successfully put into law to organize the Federal National Mortgage Association to buy and sell insured mortgages. This act was incorporated (February 10, 1938) and came under the control of the Reconstruction Finance Corporation.

f. From time to time the insurance premium rates have been modified on property improvement loans. The rate has been reduced from the original 3/4 of one percent to the present 1/2 of one percent.

g. President Roosevelt's "President's Reorganization Plan", which became effective on July 1, 1939, set up a Federal Loan Agency, whose purpose was to coordinate and supervise other agencies which included the FHA.

Commencing with the outbreak of hostilities in Europe, when Hitler's Nazi Germany invaded Poland, September 1, 1939, the activities became geared to wartime contribution in the field of housing. A new Title IV, Defense Housing Insurance, was added to the act and soon became the dominent vehicle for mortgage insurance (begun in March, 1941). Prior to the entry of the U. S. into World War II, contributions were made with other governmental agencies in the field of war housing and priority designation for critical materials in housing construction. The National Housing Agency was begun by an executive order of February 24, 1942. Housing agencies all became subordinate to this agency. Other war time measures included stimulating the production of rental housing for war workers. Private construction not serving essential war needs was stopped on April 9, 1942, by a War Production Board Limitation Order.

Also in 1942, the President urged the mortgagors to accelerate payment of mortgages and other debts as a method of reducing inflation. Prepayment premiums of one percent were waived for this period. In 1944, there commenced a combined effort between the Federal Housing Administration and the Veterans Administration to cooperate in extending available facilities to returning servicemen. The VA would guarantee the loan (in lieu of equity not to exceed $2,000) and the FHA would insure the mortgage. Upon termination of this type of financing, some 327,000 mortgages had been processed.

After World War II, a housing shortage developed which resulted basically from returning servicemen and migrating populations returning to areas where housing construction had been reduced to essential war time needs. The Veterans Emergency Housing Act of 1946, extended authority to insure mortgages under Title IV of the National Housing Act, thereby putting maximum effort on production of veterans' housing, particularly rental housing. President Truman's Reorganization Plan No. 3, of July 27, 1947, established a Housing and Home Financing Agency to replace the National Housing Agency.[10]

The Housing Act of 1948, was an attempt to encourage private concerns to construct housing in the lower price and rental ranges. It also attempted to form a bridge for the transition from the emergency to normal peace time conditions in home financing.

The outbreak of hostilities in Korea on June 25, 1950 made additional credit controls necessary to conserve building materials and to act as a curb on inflation. The credit restrictions were reenforced when the administrative

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[10]In summary, the original Federal Housing Administration resulted from the National Housing Act of 1934. The FHA became subordinate to the Federal Loan Agency in the President's Reorganization of 1939. The National Housing Agency was begun by executive order in 1942 with the FHA as a subordinate agency. The NHA was replaced by the Housing and Home Financing Agency with the President's Reorganization Plan of 1947. (The 1942 modification changed the Federal Housing Administrator to Federal Housing Commissioner.)

rules were amended to conform to the provisions of the Federal Reserve Board's Regulation X (loans above $2,500). Also insured property improvement loans became subject to the Federal Reserve Board's Regulation W affecting consumer credit (loans less than $2,500). Both these restrictions have since expired. Throughout the Korean War efforts were made to increase production of housing in the most critical areas such as military, defense and low cost housing and to make housing available to minority groups.

During the Eisenhower Administration, the Federal Housing Administration repaid to the Treasury the amounts advanced during the early years to establish the insurance funds. The total amount paid was 85.9 million dollars of which 20.3 million dollars was interest. On the other side of the ledger were the unfortunate investigations of reported abuses under the property improvement programs and the postwar housing program. This situation weakened morale within the organization and threatened confidence in its integrity. Recommended changes, safeguards and revisions were included in the Housing Act of 1954. More attention was being devoted, during this period, to urban renewal.[11] Military housing support was included in the Capehart Act (1955). The Housing Act of 1956, provided for consideration of the elderly. Through 1958, the insurance written totaled in excess of 53 billion dollars, helped to provide homes for five million families, and housing for 800,000 other families in rental and cooperative projects. In addition, home improvements were made on

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[11]An interesting aside in the urban renewal area was the result of the exercise of eminent domain through the heart of a blight area in Providence, Rhode Island, to make way for a freeway. After the slums were torn down and the freeway completed, the whole area took on a new appearance as the entire neighborhood began to improve, paint and repair their properties in a manner they thought unnecessary previously.

22 million properties. Property improvement delinquencies were at a new low of less than one percent and home mortgage default was less than six in every thousand. Such are the imposing statistics for governmental intervention in the field of housing.

Urban renewal, blight removal, slum clearance, or whatever term might be used, is a challenge to city, county, state and federal metropolitan planners. This is an internal problem of greatest magnitude. Assuming a section of a city has been declared a blight area, the cost of moving the tenants, razing the buildings, and constructing whatever type of buildings are required, is usually prohibitive. Few city or county governments desire to tackle this problem because if the area is developed into low cost housing it is even harder to gain eventual recovery of the cost. Certainly private enterprise could not successfully pursue this. Nor could a local government absorb the cost. The state and federal government could assist. It was based on this need that portions of the comprehensive Housing Act of 1949 was based. This legislation recognized slums as a national problem. In addition, this legislation made funds available to clear urban land.

One of the most hotly debated issues, that of federal aid for housing of low income families is closely related to slum clearance in that the same area cleared usually will be utilized for low cost housing. However, this is not always the case nor is it the reason that the issue becomes one of controversy. The issue rotates around two points of view. The viewpoint favoring public housing policies will assist in the maintenance of minimum standards of decent housing as a basic requirement of society. On the other hand we have the opinion that regimentation goes to the very heart of the "American system" and public housing is another step toward the welfare state. In spite of the

clear split in opinion, federal aid to local municipalities was permitted by the United States Housing Act of 1937 (to provide housing for lowest income families, etc.). This act eventually provided 191,700 dwelling units in 268 localities. The Housing Act of 1949, authorized fiancial aid for the building and operation of 810,000 additional low rent housing units over a six year period. Federal aid for housing for low income families remains a controversial issue. This can be attested by Congressional rejection of an Executive plan of 1954-1955, for an additional 35,000 units. Urban renewal is a problem of our times that has not yet been solved.

One possible solution is the honest effort which some American industrial concerns are making in the urban renewal program. The most recently completed project is the $10.5 million River Park, a townhouse and apartment area in Washington, D. C., developed by Reynolds Metal Company for cooperative ownership. Reynolds is a veteran in the urban renewal field, since in the last four years, the company has invested over $300 million in such projects. Other major industrials showing interest include U. S. Steel, Bethlehem Steel, Kaiser Aluminum & Chemical Corporation, the Aluminum Company of America and General Electric.

The most recently announced project[12] will see a team effort by Reynolds and GE for a $25 million housing project in Louisville, Ky. This FHA insured project will ultimately contain some 1,000 high rise apartment units, a motel, several restaurants, and related recreational needs. This development will be in downtown Louisville on a riverfront location.

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[12]"Glitter of Real Estate Lures Industry Dollars", Business Week, March 2, 1963, p. 32

These companies see this as a business opportunity -- an investment, either short or long term -- and in addition they will have a built in market for their products, i.e., electric appliances by GE in the Louisville project. The profit motive is there, but there is much to be admired in the social and civic benefits derived in such urban renewal projects as this.

PART III CONCLUSIONS REGARDING THE RELATIONSHIPS BETWEEN THE BUSINESS CYCLE AND THE REAL ESTATE FIELD

Chapter 6 -- Conclusions

"Under all is the land. Upon its wise utilization and widely allocated ownership depend the survival and growth of free institutions and of our civilization."[1]

It is an accepted practice for some companies to own their real estate holdings in fee simple so as to run no risk of possible loss of the properties. At the same time other companies prefer to lease their real estate holdings in order to write off the rental cost as operating expense in the normal accounting period of the business. Whichever practice is followed there still exists the point that these companies have considered what is best for them in any economic atmosphere -- prosperity or depression.

By the same token it would appear wise to ascertain the validity of the thinking which goes into making business decisions in lieu of the comments made up to this time in this paper. If business decisions regarding real estate can be tied to the business cycle then the purpose of this paper will have been fulfilled successfully.

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[1]Code of Ethics Preamble, National Association of Real Estate Boards, Philip A. Benson, Nelson L. North and Alfred A. Ring, Real Estate Principles and Practices, Fourth Edition, op. cit., p. 498.

A basic means of utilizing the real estate field as a barometer for general business conditions is the ability (or inability) of a potential buyer (industrial, commercial, or residential) to gain a mortgage note from the lending institutions. If the potential buyer is in a time-space frame in which funds are available, it could be a reflection on the valuation of the property, (including a sound appraisal and the purchasers ability to meet the payments) and the ability and desire of the lending institution to be of assistance to the borrower. In an expansion or peak phase, the banks, savings and loan association, insurance companies and other mortgage lenders see a sound economy with a developing potential.

On the other hand, in a contracting or revival phase the lending institutions may be cautious and hesitant in lending. It would appear this is a form of sound forecasting as to what type of economic climate is prevailing by the attitude of the lending institution toward borrowers generally. Carrying this attitude one step further, if the economy is enjoying a high level of prosperity, but is threatened with a possible recession, wouldn't it appear wise for the lending organization to encourage mortgage note borrowing by making funds available and by reducing mortgage note interest rates? Some localities in the country began lowering interest rates in the fall of 1962 to keep lending funds busy and to forestall the threatened recession.[2] Rather than have more and more funds available for home mortgages only to have them go begging for want of a borrower, the lending institutions prefer to accept a lower interest

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[2]The Wall Street Journal, Wednesday, October 10, 1962. After a survey of lending institutions the Journal reported further that the supply of funds were piling up faster than the borrowers demand for these funds in the form of loans. The rates dropped by a quarter to one half of one percent lower than what they were a year earlier.

rate and at least to keep the assets of the organization busy bringing in revenue.

Mention should be made of the dependence of one industry upon another. This is particularly true in real estate.[3] While many building units that are not new may be sold, the newer properties are more attractive to potential buyers. But new buildings also bring the interrelation and interdependence of of many manufacturers whose products are used in their construction. And if new buildings cannot be sold, it is only a question of time until the failure to sell backs up along the system of suppliers. It would appear that the most difficult time to sell would be during economic adversity. Following then should be a conclusion that if depression is the effect, one of the causes could be the sluggish real estate market. And the analyzing of this market could effectively serve as a barometer of the business cycle. Herein is another razor-sharp differentiation in the use of terms. The Gross National Product will reflect new construction but not existing construction changing hands. But it would be difficult to visualize a situation in which one type of construction (e.g., new) was selling and another type of construction (e.g., not new) was not selling. It would appear that both types would either sell or not sell at the same time. This is the point which should be brought into better focus by the forecasters. We should recognize that both types of sales could be of assistance as a barometer.

There is an appreciation of the employment percentage required for the expansion and peak to be present in the economy. Also appreciated should be the recognition of the real estate market as a source of employment. This is true particularly in the new construction aspect of the very problem under

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[3]"The Careful House Hunter," Time, April 5, 1963, stated it as follows: "When housing does well, so do a lot of other industries: steel, lumber, glass, appliances and furniture...."

consideration because of its influence upon the Gross National Product.

Recognition of price level changes is important in business cycle discussions regarding real estate, for the same reasons as in other capital expenditures discussions. The practice of using only acquisition costs without regard to adjustment for price level changes is in error. Acquisition costs in a rising economy tend to show a paper profit, but adjustments for price level changes will correct this situation.

The relationship of the economic aspects of supply and demand is vital to the real estate market. Because of this, the validity of using the commodities available and the demand for those commodities should prove worthwhile in forecasting future economic conditions based upon present economic considerations. This is particularly true in considering the regional nature of the real estate market.

In an analysis of population changes, the net increase in totals is the determining factor. Regarding births, it should be remembered that recorded births will not be translated into housing requirements for approximately twenty-odd years when marriageable age is attained. Even with this time span restriction included, here is another tool for forecasting housing needs far into the future, in both good and bad times.

One of the necessary cautions which must be developed in the use of real estate criterion is the one generated by housing shortages. If values rise simply because of lack of the supply of house and housing units, it should not be misinterpreted as a healthy prosperity sign with continuing bidding up of existing properties. But the value of housing shortages analysis is to isolate and define the problem and recognize it as an economic problem which may require local, state or federal support in some measure. Also such information, if

given wide publicity will cause the public to become aware of the problem with a hope that the bidding up of housing will be reduced.

The reverse of this is true with a growing vacancy rate developing in a local community as a result of a rise in unemployment and an emigration from the most sorely affected areas. The vacancy rate will not only mount but will cause construction to be used only to a minimum extent, aggravating both the unemployment rolls and the real estate market. Here is a symptom of a real economic problem. Historically, this is the very problem which existed in 1925, but the real estate ill was ignored by the national economy except as a chronic ailment confined to the real estate and related industries. What a shock the crash of 1929 was to the country, and yet the warning of weaknesses in the economy had appeared in the real estate field (and elsewhere) much earlier. Had these weaknesses been recognized and acted upon, there might have been afforded opportunities for shaking out some of the problems and forestalling or minimizing the herculean effects of the Great Depression.

Housing shortages, as critical as those mentioned above are of value for such other analysis as may be deemed helpful. The degree of criticality would determine whether the government should intervene with rent controls or other intervention which might be required for the common good and to prevent isolated abuse of the situation.

In the area of tenure, and the decision to buy, the fact that the potential buyers are ready, willing and able to buy gives a good indication of the optimism in the market place. This potential buyer is ready to put part or all of his life's savings on the line for a downpayment and to commit his regular income for an extended period of time for monthly payments and to test his credit standing in the transaction. This appears, as a general rule, to

have a better chance of happening in good times when the future is full of opportunities and potentials. Here again is a sign of the times and a barometer of the future. The reaction of the potential buyers' lending institution to the mortgage note application will be another sign indicating the conditions within the economic sphere.

In summary two points are essential for relating the real estate market to the business cycle development:

1. The existing real estate barometers which are easily incorporated into the Gross National Product should be utilized and expanded.
2. The additional real estate market, meaning other than new units, may not be acceptable for inclusion in the Gross National Product but should be considered for purposes of forecasting and use as a barometer.

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